

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point on the assignment.

Note this is due the **Wednesday** after break because my classes are cancelled on that Friday.

- 1) (25 points) Explain  $C = f(W + Y_1 + Y_e)$ . In particular, state what the three terms are, explain why we add them together, and why consumption depends upon that.
- 2) (20 points) Bethany College gave the employees a one-time bonus last fall. According to the *permanent income hypothesis*, what do you think was effect upon consumption in the area? Explain your logic.
- 3) (30 points) The *permanent income hypothesis* and the *life-cycle hypothesis* both explain why people may have a short-run MPC that is low, but a long-run MPC that is high. Implicitly they are the same theory. Explicitly, they are different. Explain two differences between them.
- 4) (25 points) Draw the income of a typical person's income over time from age 18 until death. Assume the person goes to college and retires 10 years before they die. Draw the permanent income the person expects to have. Explain why you drew both lines as you did.